

CREDIT OPINION

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New Issue

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Alaska (State of)

New Issue - Moody's downgrades Alaska GO to Aa1 from Aaa, assigns Aa1 to \$151.2M GO Series 2016A; outlook negative

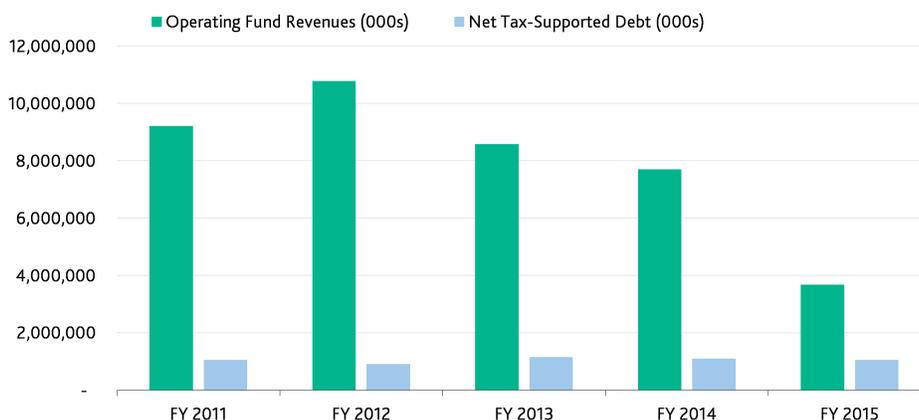
Summary Rating Rationale

Moody's Investors Service has downgraded the State of Alaska's general obligation rating to Aa1 from Aaa and assigned a Aa1 rating to the state's General Obligation Bonds, Series 2016A. The downgrade affects \$744.2 million of outstanding GO debt. Concurrently, we have downgraded lease appropriation bonds and certificates of participation to Aa2 from Aa1 and the state's moral obligation debt to Aa3 from Aa2.

The downgrade to Aa1 reflects the heightened volatility in Alaska's revenues and the unprecedented structural imbalance caused by it. The state's financial reserves are large, but recent budgets have been calibrated to oil prices above \$100 per barrel, not prices forecasted to be less than half that though the next four years. Even with significant spending reductions, recurring revenues cannot keep pace with recurring expenditures, and the state would deplete its main budgetary reserves by fiscal 2019, absent significant changes in its financial framework.

Exhibit 1

Operating Revenues Follow Oil Prices Down While Debt Remains Low



Source: Moody's Investors Service

The governor has proposed such changes, offering a plan that would reduce direct volatility of oil prices in the state's budget, diverting half of the state's oil revenues to the state's \$50 billion Permanent Fund. It also creates new taxes and reforms certain tax credits. This sovereign wealth fund-like model assumes that investment earnings through the next four years could provide a level amount of revenue to the budget and help to return to a structurally balanced position, provided that expenditures remain essentially flat. We believe the plan would be a positive step for Alaska's finances, but it introduces investment earnings risk that isn't a significant budgetary factor now. Moreover, deposits into the state's Permanent Fund would become subject to oil price volatility. The plan's assumptions also would be strained if the state wants to increase expenditures in the future.

On balance, these factors could provide Alaska a greater degree of budgetary stability than it has today. However, the plan faces numerous implementation risks. The measure is still being considered by the legislature and faces political hurdles since it would reduce the popular dividend payment that all Alaskans receive and also impose an income tax, which Alaskans have not been subjected to for 40 years. Even if the proposal is enacted, the state still faces budgetary risks related to its narrow oil-dominated economy.

Credit Strengths

- » Large but shrinking financial reserves
- » History of conservative fiscal practices
- » Willingness to consider bold changes in fiscal management, such as shifting to a sovereign wealth fund-like model

Credit Challenges

- » Unprecedentedly large 68% structural budget gap
- » Narrow economic base
- » Relatively weak pension funding

Rating Outlook

The negative outlook reflects ongoing stress in Alaska's economy and finances caused by extraordinary revenue volatility, with oil prices well below prior forecasts. Absent significant changes, low oil prices will continue to cause large budget deficits, reserve draws, and structural budget gaps of an unprecedented size for a US state.

Factors that Could Lead to an Upgrade

- » Record of maintaining structural budget balance
- » Record of implementing changes in fiscal management that reduce revenue volatility
- » Sustained improvement in pension funding metrics

Factors that Could Lead to a Downgrade

- » Failure to implement measures to achieve structural budget balance
- » Depletion of financial reserves
- » Accelerating declines in petroleum production volume

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key Indicators

Exhibit 2

Volatility in Oil Prices Has a Negative Impact on Alaska's Operating Fund Revenues

Alaska	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Operating Fund Revenues (000s)	9,217,341	10,785,224	8,577,583	7,706,982	3,678,644
Balances as % of Operating Fund Revenues	206.1%	211.0%	301.6%	353.2%	579.0%
Net Tax-Supported Debt (000s)	1,050,800	914,900	1,156,400	1,097,200	N/A
Net Tax-Supported Debt/Personal Income	3.3%	2.8%	3.2%	3.0%	N/A
Net Tax-Supported Debt/Personal Income 50 State Median	2.8%	2.8%	2.6%	2.5%	N/A
Debt/All Governmental Funds Revenue	5.5%	6.8%	7.3%	6.5%	N/A
Debt/All Governmental Funds Revenue 50 State Median	22.7%	24.3%	23.8%	23.0%	N/A
Adjusted Net Pension Liability/All Govt Funds Revenue	55.2%	74.0%	99.3%	85.2%	N/A
Adjusted Net Pension Liability/All Govt Funds Revenue 50 State Median	48.7%	63.9%	60.3%	59.2%	N/A
Total Non-Farm Employment Change (CY)	1.7%	1.5%	0.5%	0.5%	0.4%
*Per Capita Income as a % of US (CY)	113.8%	112.9%	112.0%	114.7%	118.1%

*Economic data for 2015 are as of third quarter 2015

Source: Moody's Investors Service

Recent Developments

Recent developments are incorporated into the sections below.

Detailed Rating Considerations

Economy

Alaska's economy is concentrated in the energy and government sectors. The state's labor market outperformed the US in the recession and during the recovery as oil prices surpassed \$100 per barrel. Since then, employment growth has been slow, reflecting both reductions in federal spending and the steep decline in oil prices. For the last three years, employment in Alaska has grown by less than 0.5% and in recent months it has been slightly negative. We do not expect employment growth to rebound strongly amid low oil prices, which we expect to persist for several years. The Moody's Investors Service [assumptions for crude oil prices](#) are \$33 per barrel in 2016, \$38 in 2017, \$43 in 2018, and \$48 in 2019.

Finances and Liquidity

Alaska relies more heavily on petroleum production taxes and royalties to fund government operations than any other oil-producing state. In recent years, as much as 90% of operating revenue was derived from the oil industry while the other oil states are all less than 20%. As oil prices slid steadily downwards the impact on the state's budget has been severe: general purpose unrestricted revenue has declined by 76% since fiscal 2013 and the state has cut spending by more than one-third since then. To fund state services, Alaska has relied heavily on its sizeable reserves: the state ended fiscal 2015 with \$10.1 billion in the Constitutional Budget Reserve Fund (CBRF) and \$7.1 billion in the Permanent Fund Earnings Reserve (PFER). As it uses reserves to fund operations, however, the resulting structural budget gap, 68% based on fiscal 2016 general fund expenditures, is unprecedentedly large for a state. Based on the size of the draws and current spending, the state expects the CBRF to be depleted in fiscal 2019, and in our analysis, this pattern could only be reversed if oil returns to \$100.

Exhibit 3

Oil Price Sensitivity & Reserve Depletion Scenarios

Oil Price	Total Unrestricted Revenue	Annual Deficit	Year of Reserve Depletion
\$30	\$1,040	(\$3,960)	2020
\$40	\$1,200	(\$3,800)	2020
\$50	\$1,590	(\$3,410)	2021
\$60	\$1,990	(\$3,010)	2022
\$70	\$2,240	(\$2,760)	2022
\$80	\$2,600	(\$2,400)	2023
\$90	\$3,300	(\$1,700)	2026
\$100	\$4,150	(\$850)	2036
\$110	\$5,010	\$10	N/A
\$120	\$5,880	\$880	N/A
\$130	\$6,740	\$1,740	N/A

Assumes \$5 billion General Fund expenditure base, fiscal 2015 CBRF balance of \$10 billion and fiscal 2015 PFER balance of \$7 billion.

Source: Moody's Investors Service

The centerpiece of the governor's plan is a proposed use of Permanent Fund investment earnings (calculated on a smoothed return basis). Those monies have historically been restricted by custom and saved. Under the governor's plan, they instead would be transferred to the state's General Fund each year. To accomplish this the plan would replace the annual dividend paid to Alaska residents from the Permanent Fund's earnings with a smaller dividend paid from half of annual mineral royalty revenues. The remainder of royalty revenue and other production-related revenue, instead of going to the general fund, would be transferred to the Permanent Fund. The estimated annual transfer to support the general fund budget is \$3.3 billion, compared to production revenue and reserve draws of \$4.4 billion in fiscal 2016. The transfer would come from the PFER. The goal of this new approach is to shield the state's operating budget from volatility in the global commodity markets while still allowing Permanent Fund principal to grow over time.

LIQUIDITY

Alaska has strong liquidity, with \$14.8 billion available to the General Fund based on the state's fiscal 2015 audit.

Debt and Pensions**DEBT STRUCTURE**

Alaska's debt is relatively low compared to other states, with just more than \$1 billion of net tax-supported debt, based on our 2015 state medians. On a per capita basis and as a percentage of personal income, however, the state's debt ratios are above average. Alaska's net tax supported debt per capita is \$1,489 (eighteenth) compared to the US median of \$1,012. Debt as a percentage of personal income is 3.0% (nineteenth) compared to the US median of 2.5%.

The state is authorized to issue up to \$5 billion of pension obligation bonds and proposals to issue up to \$2.5 billion this calendar year are being considered. An issuance of that size, expected to be secured by state appropriations, would significantly weaken Alaska's debt ratios. Using the same denominator as our 2015 medians, \$2.5 billion of additional debt would increase the debt to personal income ratio to 7.9%, fourth among states.

DEBT-RELATED DERIVATIVES

Alaska has no variable rate debt and is not party to any interest rate swaps.

PENSIONS AND OPEB

Alaska has an above-average employee pension burden among the states, based on unfunded liabilities for its share of multi-employer cost sharing plans. For the state's two biggest pension plans, based on our calculations, the state is responsible for 79.6% of PERS funding and 87% of TRS funding. Alaska's overall as-reported liabilities total \$7.7 billion.

The state's adjusted net pension liability (ANPL), under our methodology for adjusting reported pension data, is \$14.3 billion, or 85% of all governmental fund revenues, based on fiscal 2014 data, the fifteenth highest ANPL-to-revenue ratio. The ANPL also reflects 25% of the state's 2014 GDP, the second highest. Alaska's three-year average ANPL ratio is 80%, eighteenth highest among the states. Moody's adjusted net pension liability applies a bond index rate to determine the present value of plan liabilities, incorporates the

market (rather than actuarial) value of plan assets, and makes certain other changes to improve comparability of reported pension liabilities. The adjustments are not intended to replace Alaska's reported liability information, but to improve comparability with other states. Alaska's share of liability for both pension plans was determined in proportion to its contributions to the plans.

Based on a decision by its Supreme Court, Alaska is one of the few states that constitutionally guarantees OPEB benefits. When the state's ANPL is recalculated to include both the pension and OPEB liability, its pension ratios grow significantly, from 85% of revenue to 169%.

Governance

Alaska utilizes multi-year financial planning and there is also financial flexibility with no constitutional caps on revenue raising or spending increases, as well as no super-majority requirements for budget passage and/or tax increases.

Legal Security

The bonds are general obligations of the state, secured by its full faith and credit.

Use of Proceeds

Proceeds of the 2016A bonds will be used to take out general obligation bond anticipation notes that mature March 18, and to help finance state transportation projects.

Obligor Profile

Alaska is the largest state based on land mass, but its population ranks 48th among the states, at 738,000. Its GDP ranks 43rd.

Methodology

The principal methodology used in this rating was US States Rating Methodology published in April 2013. The additional methodology used in the lease-backed rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. The additional methodology used in the moral obligation rating was Moody's Approach To The Moral Obligation Pledge published in November 2008. Please see the Ratings Methodologies page on www.moody.com for a copy of these methodologies.

Ratings

Exhibit 4

ALASKA (STATE OF)

Issue	Rating
General Obligation Bonds Series 2016A	Aa1
Rating Type	Underlying LT
Sale Amount	\$151,180,000
Expected Sale Date	03/08/2016
Rating Description	General Obligation

Source: Moody's Investors Service

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